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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-125580-07

Date:
November 28, 2007

Legend:

$$\underline{X} =$$
State =

D1 =

D2 =

Trust =

Dear

This responds to the letter dated May 25, 2007, and related correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code (“Code”) for an inadvertent termination of S election.

FACTS

The information submitted states that X was incorporated under the laws of State on D1, and elected to be treated as an S corporation effective D1. On D2, a portion of the stock of X was transferred to Trust, an ineligible shareholder.

X and its shareholders represent that they intended that Trust elect to be treated as an electing small business trust (ESBT) effective D2, and consistently treated Trust as such. The trustee of Trust, however, did not file a timely ESBT election.

LAW AND ANALYSIS

Section 1361(a)(1) defines an “S corporation” as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1361(c)(2)(A)(i) provides that a trust, all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States, may be an S corporation shareholder.

Section 1361(c)(2)(A)(v) states that an ESBT is a permissible shareholder of an S corporation.

Section 1361(e)(1) defines an ESBT, in part, as a trust if—

- (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), or (IV) an organization described in section 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary,
- (ii) no interest in such trust was acquired by purchase, and
- (iii) an election under this subsection applies to such trust.

Section 1361(e)(3) provides that an election to be an ESBT shall be made by the trustee. Any such election shall be applied to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of

§ 1361(b) or to obtain shareholder consent, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely upon the representations made and the information submitted, we conclude that the S election of X terminated on D2, when a portion of the stock of X was transferred to Trust. We further conclude, however, that the termination was an inadvertent termination within the meaning of § 1362(f).

Under § 1362(f), Trust will be treated as an ESBT effective D2, provided Trust qualified as an ESBT from D2 and make any adjustments that are necessary to comply with this ruling. X will be treated as an S corporation from D2, and thereafter, provided that X's S election was otherwise valid and has not otherwise terminated under § 1362(d).

This ruling is contingent upon X and all its shareholders treating X as having been an S corporation and Trust as an ESBT for the period beginning D2, and thereafter. Within 60 days from the date of this letter, the trustee of Trust shall file an ESBT election on behalf of Trust with the appropriate campus. If these conditions are not met, then this ruling is null and void.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code, including whether X was otherwise eligible to be an S corporation, or whether Trust was otherwise eligible to be an ESBT.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling will be sent to your authorized representative.

Sincerely,

David R. Haglund
Senior Technician Reviewer
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes

cc: